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Committee of Experts on International Cooperation in Tax Matters

Report on the fourth session (20-24 October 2008)

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Note

Symbols of United Nations documents are composed of capital letters combined with figures.

Summary

The present report contains the conclusions and recommendations of the fourth session of the Committee of Experts on International Cooperation in Tax Matters, held at the United Nations Office at Geneva from 20 to 24 October 2008. The Committee, which was established by the Economic and Social Council by its resolution 2004/69, consists of 25 experts appointed in their personal capacity for a four-year period. The Committee dealt with the following substantive items: (a) general issues in the review of the commentaries; (b) taxation of development projects; (c) definition of permanent establishment; (d) improper use of treaties; (e) exchange of information, including the United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance; (f) revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries; (g) dispute resolution; and (h) treatment of Islamic financial instruments. The Secretariat also gave a briefing on the linkage of the mandate and work of the Committee to the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus, to be held in Doha from 29 November to 2 December 2008, and the Committee had lengthy discussions on that issue.

On the basis of the discussion of the above-mentioned topics, the Committee also produced a set of conclusions and recommendations for consideration by the Economic and Social Council, Member States, the future membership of the Committee and the Secretariat, as appropriate.

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Chapter I
Introduction

1. Pursuant to Economic and Social Council resolutions 2004/69 and 2008/16, the fourth session of the Committee of Experts on International Cooperation in Tax Matters was held in Geneva from 20 to 24 October 2008.

2. The fourth session of the Committee of Experts was attended by 22 experts and 108 observers. The following members of the Committee of Experts attended the session: Moftah Jassim Al-Moftah (Qatar), Bernell L. Arrindell (Barbados), Noureddine Bensouda (Morocco), Rowena G. Bethel (Bahamas), Nahil L. Hirsh Carillo (Peru), Paolo Ciocca (Italy), Christian Comolet-Tirman (France), Andrew Dawson (United Kingdom of Great Britain and Northern Ireland), Miguel Ferre Navarrete (Spain), Liselott Kana (Chile), Kyung Geun Lee (Republic of Korea), Tizhong Liao (China), Habiba Louati (Tunisia), Ronald Peter van der Merwe (South Africa), Robin Moncrieff Oliver (New Zealand), Frank Mullen (Ireland), Dmitry V. Nikolaev (Russian Federation), Serafin U. Salvador, Jr. (Philippines), Stig Sollund (Norway), Robert Waldburger (Switzerland), Armando Lara Yaffar (Mexico) and Eduardo Zaidensztat Capnikas (Uruguay).

3. The session was also attended by observers for Albania, Argentina, Australia, Austria, Azerbaijan, the Bahamas, Bangladesh, Barbados, Belgium, Brazil, Cambodia, Cameroon, Canada, Chile, Croatia, the Czech Republic, Denmark, Germany, Haiti, India, Iraq, Italy, Japan, Kuwait, Latvia, Lebanon, Liechtenstein, Malaysia, Monaco, Morocco, the Netherlands, Nigeria, Norway, Pakistan, Portugal, Qatar, Romania, Saudi Arabia, Senegal, Singapore, Slovenia, Spain, the Sudan, Swaziland, Switzerland, Thailand, Turkey and Viet Nam, as well as by observers for the Isle of Man (Crown Dependency of the United Kingdom) and the Holy See.

4. The session was attended by observers for the following intergovernmental organizations: the European Commission, the Inter-American Development Bank, the International Monetary Fund, the Organization for Economic Cooperation and Development (OECD) and the Southern African Development Community.

5. The session was also attended by observers for the following other entities: the International Bureau of Fiscal Documentation, the International Chamber of Commerce and the Tax Justice Network. The following participants attended the session in their personal capacity: Tomas Balco, Jon E. Bischel, Frank L. Brunetti, Stephen R. Crow, David Davies, Bruno Gurtner, Ghislain T. J. Joseph, Woo Taik Kim, Toshio Miyatake, T. P. Ostwal, Sol Picciotto, Hans Pijl, Roy Rohatgi, Haula Rosdiana, Christoph Schelling, Shosh Shacham and Ian Young.

6. The amended agenda and documentation for the fourth session was as follows:

1. Opening of the meeting by the Chairperson of the Committee.
2. Adoption of the agenda and organization of work (E/C.18/2008/1 and E/C.18/2008/CRP.9).
3. Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus (E/C.18/2008/2).

4. Discussion of substantive issues related to international cooperation in tax matters:

   (a) General issues in the review of commentaries (E/C.18/2008/CRP.1 and Add.1);

   (b) Taxation of development projects;

   (c) Definition of permanent establishment (E/C.18/2008/CRP.3);

   (d) Improper use of treaties (E/C.18/2008/CRP.2 and Add.1);

   (e) Exchange of information, including proposed Code of Conduct (E/C.18/2008/3 and Corr.1 and Add.1 and Add.1/Corr.1);

   (f) Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries (E/C.18/2008/CRP.5 and Add.1 and 2);

   (g) Dispute resolution (E/C.18/2008/CRP.6 and Add.1);

   (h) Treatment of Islamic financial instruments (E/C.18/2008/4 and Corr.1).

5. Dates and agenda for the fifth session of the Committee.

6. Adoption of the report of the Committee on its fourth session.

Chapter II
Organization of the session

A. Opening of the session by the Chairperson of the Committee

7. On 20 October 2008, the first meeting of the fourth session of the Committee was opened in Geneva by Noureddine Bensouda, Chairperson of the Committee. Rowena Bethel was Rapporteur, in accordance with her election as Vice-Rapporteur at the third session. The observer for Canada, Sophie Chatel, assisted Ms. Bethel in that role.

B. Adoption of the agenda and organization of work

8. The proposed agenda was adopted by consensus. The Deputy Secretary of the Committee, Michael Lennard, announced the appointment of three new members: Christian Comolet-Tirman (France), Liselott Kana (Chile) and Robin Oliver (New Zealand) to complete the terms of office of Pascal Saint-Amans (France), Patricia Brown (United States of America) and Nobuyuki Nakamura (Japan), which would expire on 30 June 2009 (see E/2008/9/Add.1). Mr. Lennard thanked the new members for the work they had already done and said that the Secretariat looked forward to working with them for the remainder of their terms of office.

C. Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus

9. In introducing the topic, the Chairperson noted the importance of the Committee considering how best to most effectively accomplish its mandate. He suggested that perhaps the time had come for an "institutionalization" of the Committee, to more clearly reflect governmental views, without making significant changes in how Committee members went about their work.

10. The Executive Secretary of the Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus (Doha Conference), Oscar de Rojas, was invited to address the Committee. He noted the connections between the financing for development process and the work of the United Nations related to tax matters, and that the need for improved tax cooperation internationally was an issue that was attracting attention during the preparations for the Doha Conference.

11. He noted that paragraph 10 of the Doha draft outcome document currently being discussed by Member States in New York addressed the issue of a possible upgrade of the Committee into an intergovernmental commission. If it happened, this would mean that the work of the body would carry greater weight in a broad political sense, as formally representing governmental, rather than personal, views. At a time when an urgent need for restructuring the global financial system was being noted at high levels, the importance of greater cooperation in tax matters was also being mentioned in that context, for example, in terms of the need to cooperate in combating tax evasion and avoidance. There was consequently a new focus on the future of the Committee and its possibilities as the only truly global forum in this

area, and it was appropriate for those participating in the work to make their views on the issue known to those negotiating in New York and Doha.

12. Mr. de Rojas noted that the issue of technical assistance and capacity-building for developing countries was one where resource constraints had limited what could be done, but the United Nations would still seek to work with other institutions and agencies active in the field to assist developing countries in addressing their tax challenges through increased cooperation.

13. Subject to any changes called for as a result of the Doha Conference, a new membership of the Committee would take up its duties from the beginning of July 2009, and current members should not assume that they would be reappointed, as membership depended on nomination by their countries and then selection through a process where adequate regional and other balances would be relevant and where demonstrated diligence in performing the duties of membership would no doubt also be a factor.

14. In the discussion that followed there was a recognition of the importance of stable and effective tax systems in achieving sustained development and of the role that the work of the United Nations in tax matters could play in the area, especially work done in conjunction with others active in the field. The need for developing countries to take a more active leadership role in that work was also stressed, so that the outcomes fully reflected their needs and aspirations.

15. In the discussion, there was a good level of support for an upgrading of the Committee to an intergovernmental commission, while recognizing that the decision was ultimately one for United Nations Member States, not the Committee itself. Those taking this view referred to the extra weight this would give to the work related to tax matters, a higher profile, which might assist the Committee to better meet its broad mandate, and the ability of Governments to engage different experts in the work depending on the issues at hand rather than having one expert addressing all the many and complex issues of tax cooperation. The need for openness and transparency in terms of any new body, including in its relationship with observers of its work, was also stressed.

16. While Mr. de Rojas indicated that the issue of a possible upgrading of the Committee was distinct from the issue regularly raised by the Committee of the lack of resources sufficient to meet its mandate, many participants emphasized that the issue remained an important one that had so far not been addressed.

17. The majority of experts who expressed their view supported the upgrade to an intergovernmental commission. A number of experts indicated, however, that they could not form a final view of the merits or otherwise of an upgrade to an intergovernmental commission without knowing what those proposing the change intended in terms of the composition and operation of the new body. They felt that they could only reach a view on the issues once they knew more of the details of such a proposal. Some expressed the view that there was a risk that such a forum could become overly politicized and therefore less able to deal with purely technical issues. Some also expressed the view that it could not necessarily be assumed that an intergovernmental commission would be better equipped than the current Committee to meet its mandate. A few experts indicated that they opposed such a change in the Committee's status, owing, among other things, to the impact such a

change might have on the status of the United Nations Model Double Taxation Convention between Developed and Developing Countries.[1]

18. Among these different views, however, there was a broad acceptance that any future body, while performing its key work on the United Nations Model Convention, would need to play a greater role in other areas, such as tax administration issues, capacity-building and transfer pricing, in order to be fully effective in meeting the challenges for developing countries.

19. Mr. de Rojas explained how various current functional commissions of the Economic and Social Council operated, including how observers were able to fully participate, with benefits to the quality of the commission outcomes, how transparency in decision-making could be achieved and how a technical focus could be preserved.

20. The Chairperson noted that the debate reflected an important exchange of views and noted also that there was value in conveying some of the ideas to the decision-makers on the issue as quickly as possible. To that end, he proposed to send a letter to the appropriate persons involved in the Doha Conference process and would circulate a draft for discussion. The letter was subsequently finalized and sent during the course of the fourth session of the Committee.

[1] United Nations publication, Sales No. E.01.XVI.2.

Chapter III

Discussion on substantive issues related to international cooperation in tax matters

A. General issues in the revision of the commentaries

21. Liselott Kana (coordinator) and Mustapha Kharbouch presented a document prepared by the Working Group on General Issues in the Review of Commentaries, comprising also Adrián Groppoli. They noted that in addressing the relationship between the United Nations Model Convention and the Organization for Economic Cooperation and Development Model Tax Convention on Income and on Capital, it was important to seek a common understanding where the same text was used in an article in both models. They had concluded that it was unhelpful merely to quote the commentaries in the OECD Model Convention without clearly expressing agreement or disagreement with the quoted passages. They also considered that paragraph 9 of the introduction to the United Nations Model Convention should be revised to be less ambivalent about the significance of quoting the OECD Model Convention in future. This was generally accepted. There were differing views as to the understanding of the text of the United Nations Model Convention where it referred to the interpretative value of the previous citations of the OECD commentaries made by the former Ad Hoc Group of Experts. There was no consensus on this latter issue.

22. The possible value of countries making formal comments on the United Nations Model Convention was discussed, with general support for some such facility, including in terms of increased transparency in negotiating positions. One expert disagreed with that view. However, there was also some discussion on the need to differentiate between the terms "observations" and "reservations" used by OECD countries for the OECD Model Convention. A reference to non-binding "positions" or even "comments", it was noted, might be better. The need to keep any such task a manageable one in view of the Committee's resource constraints was also noted.

23. There was broad consensus on the need to avoid identifying views as being made by "developing" or "developed" countries where that was not an accurate description of the range of views. However, it was agreed that this did not mean that the United Nations Model Convention would cease to be a model for treaties between developing and developed countries, or that the focus in the Committee's mandate on the needs of developing countries would be in any sense diminished. The suggestion was made to categorize the different views, where possible, by their key characteristics relevant to the different positions, such as by those favouring source- or residence-based taxing rights, or being either a capital importing or a capital exporting country.

24. The suggestion to differentiate clearly between positions taken by the former Ad Hoc Group of Experts, on the one hand, and by the current Committee, on the other, was also accepted.

25. **The Working Group was tasked to continue its work in considering general issues in the review of the commentaries, with a view to a further paper being available to the new membership of the Committee in 2009.**

B. Taxation of development projects

26. Victor Thuronyi presented a short update on taxation of development projects on behalf of International Tax Dialogue, noting that a meeting of donor and recipient countries to discuss the guidelines presented the previous year had not yet occurred owing to the controversial nature of the guidelines for some donors, other priorities and perhaps a misunderstanding of the proposal, given its technical nature.

27. **Mr. Thuronyi urged participants to discuss the issue with their relevant ministries or agencies in their capitals, and it was agreed that wording would be provided to the Chairperson so that he could consider whether it could be included in his proposed letter on the Doha Conference referred to in paragraph 20 above. The matter was subsequently addressed in the Chairperson's letter.**

C. Definition of permanent establishment

28. Stig Sollund and Hans Pijl noted that the redrafted commentary on the existing text of article 5 had been finalized in accordance with the decision of the Committee at its third session, but that the paper for consideration at the current meeting involved the next step of suggesting improvements to the text of article 5 and providing an accompanying commentary. Mr. Sollund and Mr. Pijl therefore presented further proposals of the Subcommittee on Permanent Establishment, comprising the following main issues:

(a) Treatment of article 14, including possible deletion;

(b) Taxation of fees for technical services;

(c) Treatment of services generally and a provision for services under article 5.

29. The presenters noted that in its work on article 14 the Subcommittee had taken as a central principle that source country taxation rights should not be diminished by its proposals. In that respect, the services provision under subparagraph 1 (b) of article 14 was preserved under the proposed article 5, retaining this clear difference between the United Nations and OECD model conventions. It was also noted that an option was provided in the paper for retaining article 14 and preserving the commentary as guidance. This was another clear difference to the OECD Model Convention, and would also assist those preferring to delete article 14 but still having, as part of their treaty network, treaties with such a provision based on the United Nations Model Convention.

30. The paper was then discussed by the participants. There were two broad views, each very well supported. The first view was that article 14 was very difficult to apply in practice owing to the wide variety of diverging interpretations and that, in removing the problematic "fixed base" concept in article 14 and relying upon the better understood term of "permanent establishment" in article 5, the Subcommittee proposal had considerable practical merit.

31. Several of those expressing this view indicated that they represented countries that had many source country provisions in their treaties and that they considered the work of the Subcommittee had successfully met its goal of preserving source

country rights under the existing United Nations Model Convention, possibly even extending them. At the same time, the proposals clarified the operation of tax treaties in specific practical situations and avoided unnecessary differences from the treaty practice of those countries, whether or not they were OECD countries, which had decided to remove article 14 from their newer treaties.

32. Among participants supporting the Subcommittee's proposal, several acknowledged that some further drafting changes would be needed to address issues raised in the discussions. This could include ensuring coverage where persons through whom services were provided were not residents of the same country as the company employing them, and also achieving greater consistency between the tax treatment of individuals providing services and persons in effectively the same situation but who operated as an incorporated entity.

33. Views against replacing article 14 were equally strongly expressed. Many opposing the article's deletion recognized that there were uncertainties and deficiencies in article 14, but preferred that the focus be on improving the article rather than deleting it. Some of the reasons given for retaining article 14 were:

(a) Deletion of article 14 would reduce source country taxing rights, based on the view that the concept of a fixed base was a broader one than that of a permanent establishment (not requiring the commercial and geographical coherence required of a permanent establishment for example);

(b) Some entities, such as individuals and partnerships, were more readily dealt with under article 14 than under the proposed paragraph 4 of article 5;

(c) The reference to the "same or a connected project" in paragraph 4 of article 5, which was alien to article 14, could reduce taxing rights;

(d) Apart from technical issues and disruption to the scheme of taxation categories under the current Model Convention, there would be very significant administrative effort involved in explaining the change and implementing it, especially in States with weaker administrations.

34. Others doubted the paper's conclusion that the provision in article 5 related to building and construction sites as permanent establishments was not a deeming provision.

35. Another issue that was raised was whether the taxation of service income would move from being on a possible gross basis under article 14 to a net basis under articles 5 and 7, although it was noted that the current United Nations commentary suggested that the same basis applied under article 14 as for article 7. The view was also expressed that it could not be assumed that taxation on gross income was worse for taxpayers than taxation on net income, as the procedures for the former were often much more convenient than those for the latter.

36. The point was made that the views expressed, options available and technical issues raised in relation to the United Nations Model Convention in the current type of discussion should be incorporated into the commentary to assist those negotiating and administering treaties.

37. On the issue of fees for technical services, several participants noted that the special characteristics of services, including in terms of modes of supply as recognized in the General Agreement on Trade in Services, needed to be kept in

mind, and the legitimate source country position needed to be more fully taken into account. The suggestion was made that provision of services through the Internet should, for example, be addressed from a source country perspective.

38. **Mr. Sollund indicated that, in view of the positions expressed, in many cases supporting the proposals for replacing article 14 and in many other cases supporting the retention of article 14, there might be a way forward that met broad acceptance. That approach could be to:**

(a) **Reconfigure the way the issue was addressed, so that article 14 was retained in the United Nations Model Convention;**

(b) **Provide an alternative for those preferring to remove article 14 and apply articles 5 and 7 to situations previously dealt with under article 14, without reducing the source country rights under the current article 14;**

(c) **Ensure that the Subcommittee liaised with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the Subcommittee. In that respect, comments could also be sent to Mr. Sollund, as coordinator of the Subcommittee, on the issues raised in the discussion concerning what would now be an alternative article 5 and its commentary for countries wishing to delete article 14;**

(d) **Focus at present on that part of the Subcommittee mandate relating to the possibility of an alternative to article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of article 14 and its commentary as matters for consideration by a future membership of the Committee.**

39. **The Subcommittee was mandated to so proceed. However, the Committee considered that the issue of updating and improving article 14 was an important one that should be dealt with by a new Subcommittee on Article 14 and the Tax Treatment of Services. Ms. Kana agreed to coordinate the Subcommittee and Habiba Louati and Anita Kapur also agreed to participate. Observers with expertise in the area would also be asked to participate in the work of the Subcommittee. The Subcommittee was asked to commence its work as soon as possible with a view to achieving as much as possible before July 2009, when the new membership of the Committee would commence their terms of office.**

D. Improper use of treaties

40. Mr. Kyung Geun Lee, coordinator of the Subcommittee on Improper Use of Treaties, introduced the revised version of the report of that Subcommittee. He noted that at the third session of the Committee, the Subcommittee had been requested to carry out further work, including consideration of whether or not the concept of beneficial ownership, currently found in articles 10 to 12, should apply with respect to other articles of the United Nations Model Convention, such as articles 13 and 21.

41. In order to address that request appropriately, the Subcommittee, with the cooperation of the United Nations Secretariat, had asked Philip Baker to submit a

consultant paper on the issues related to beneficial ownership noted above. Mr. Lee invited Mr. Baker to present that paper to the Committee.

42. In his presentation, Mr. Baker referred to the history of beneficial ownership provisions and their treatment in the courts. He pointed out the uncertain nature of the concept of beneficial ownership and the differing understandings of what it meant in different languages and countries. This had led to some lengthy court proceedings, as noted in the paper. He further explained that while some viewed the term as being an undefined term to which recourse might be had under domestic law (as a consequence of article 3, para. 2 of most tax treaties) others considered that it had an "international fiscal meaning", especially in view of its use in the United Nations and OECD model conventions. The uncertainty as to the exact international fiscal meaning of the term was, however, noted.

43. Mr. Baker expressed the view that beneficial ownership was a narrow provision designed to counter only certain specific examples of treaty shopping, and he noted that both of the models, as well as treaty practice, supported the use of other more specific treaty shopping provisions. He said that while there was no reason the concept could not be extended to other articles, including articles 13 and 21, each article had to be considered on its own merits. He concluded that article 21 was a possible area for inclusion, but that the existence of paragraph 3 of that article preserving source country taxing rights in the United Nations Model Convention, as compared with the OECD Model Convention, meant that there was less of a need for the beneficial ownership concept for treaties based on the United Nations Model Convention than for treaties based on the OECD Model Convention. As for article 13, he considered that the most likely types of abuse involving that article, such as transfers of residence, would not necessarily be countered by such a provision.

44. On the possibility of a general beneficial ownership provision, Mr. Baker indicated that this would have the benefit of general application, but would only apply very narrowly. In most cases where contracting States were mindful to have such a provision applying to the treaty as a whole, they would have a more detailed provision.

45. Mr. Baker noted that there was room for greater clarity concerning the term "beneficial ownership", including in relation to its practical application.

46. When the issue was discussed by participants, many of them pointed out the lack of clarity concerning the concept of beneficial ownership, including its practical application, such as in relation to certification of beneficial ownership. It was noted that the interpretations of the term held by tax administrations had often not been shared by the courts. While the uncertainties of the term were widely noted, so too were the risks in seeking to define the term in greater detail, in view of the different conceptions of the term's meaning. There was ultimately only limited support for inserting beneficial ownership in article 13 or 21 or in any other articles, or for a general beneficial ownership provision.

47. **It was concluded that there was a need to refine (fine-tune) the concept of beneficial ownership, including by examining developments in the OECD Model Convention, and it was agreed that Mr. Baker's paper could contribute to the process of improved understanding by its appropriate inclusion in the**

Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.[2]

48. **It was also agreed that practical application of the concept of beneficial ownership, including how to certify beneficial ownership, should be recommended to the next membership of the Committee as a subject worthy of its consideration, one which could be elaborated on in the Manual. In that respect, any cases and materials on the application of the concept of beneficial ownership in developing countries would be particularly useful for such consideration. Taking into consideration the work being done at OECD, it was also agreed to have feedback from OECD as to its work on beneficial ownership.**

49. **Having decided that there was no need for the Subcommittee on Improper Use of Treaties to further examine the issue of beneficial ownership, attention turned to the Subcommittee's paper on proposed additions to the United Nations Model Convention and commentary addressing approaches to dealing with improper use of treaties. The paper was a revised version of the paper presented at the third session. It was agreed that the paper was finalized, subject to a small number of minor changes. This included examining whether the proposed paragraph 5 of article 13 should be expressed, as in the current Model Convention, as not affecting paragraph 4 and, if necessary, making that change. The changes also included ensuring that in the same paragraph 5 the reference to "that State" was changed to "that other State", to ensure that it referred to the State of residence of the company.**

50. **After the Committee had finished its discussion of dispute resolution, and in the light of that discussion, it decided to remove the square brackets surrounding text in the last sentence of paragraph 103 of the report contained in conference room paper E/C.18/2008/CRP.2, but to also delete the phrase ", combined with arbitration to deal with cases that competent authorities cannot resolve,". The last sentence of paragraph 103 would then read:**

> **"Similarly, an effective application of the mutual agreement procedure will ensure that disputes concerning the application of anti-abuse rules will be resolved according to internationally accepted principles so as to maintain the integrity of tax treaties."**

51. **The Chairperson noted that this concluded the work of the Subcommittee on Improper Use of Treaties and he thanked the Subcommittee for its successful work.**

E. Exchange of information, including the proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance

52. Miguel Ferre Navarrete presented the paper of the Subcommittee on Exchange of Information on a proposed new article 26, in relation to which there had been only a small number of outstanding issues after consideration at the third session of the Committee.

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[2] ST/ESA/PAD/SER.E/37.

53. There was a general discussion, in which the importance of effective exchange was noted. Some participants noted the legal constraints that some administrations faced in respect of some exchanges of information, especially in relation to laws allowing exchange of bank information only where a criminal matter or a court procedure was involved, or where such information was available only on request.

54. A significant number of participants noted, however, that their countries would conclude bilateral tax treaties only if they included an article 26 in the proposed form, that they would be looking to amend their existing treaties to the same effect, and that banking secrecy provisions were inconsistent with that approach. The impact of tax evasion and avoidance on the development of developing countries was noted, as was the need for strong exchange of information as one measure to combat this.

55. **Based on the discussion, the proposed new article and its commentary was agreed to be finalized, the only change being that in paragraph 2 the words "However, if the information is originally regarded as secret in the transmitting State," should be removed and replaced with the word "and", as it was not considered that this conditionality was necessary to the paragraph.**

56. Mr. Ferre then introduced the proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance. He noted that it would be aimed at Governments and would be non-binding.

57. There was a consensus in favour of the concept of such a Code of Conduct, although it was recognized that this was an early draft and that further work should continue on the Code.

58. Some of the points raised on the draft were:

(a) In the "goals" section of the draft Code, the suggestion that there should be publicly available data on all taxable entities would excessively burden many developing countries: the need to minimize the burdens cast on developing countries agreeing to the Code was noted;

(b) In the same section of the draft Code, there was no reason for confining the operation of paragraph (e) to new "ring-fencing" measures only, otherwise it would advantage countries having such measures already in place;

(c) It was important that the Code should not create a climate unfavourable to legitimate business transactions and that this should be borne in mind when redrafting it. In that context, there was a discussion about the extent of the Code's coverage. While the general view was that it should not address only criminal matters (tax evasion), the manner in which it dealt with tax avoidance and the like would have to be evaluated on a case-by-case basis, bearing in mind the different ways in which such terminology might be used internationally. There was some discussion also of whether the title should refer only to tax evasion or to tax avoidance as well.

59. **It was agreed that the Subcommittee should continue its work on the Code, drawing on the discussions and the submissions that had been invited, which would include submissions on the title, structure, goals, objectives and commitments outlined in the document.**

60. **It was also agreed that an updated version of the Code should be made available by the time the Doha Conference took place, with an introductory paragraph and styled as a "technical working draft" or similar.**

F. Dispute resolution

61. While there was no paper prepared by the Subcommittee on Dispute Resolution before the session, Robert Waldburger, coordinator of the Subcommittee, and Jacques Sasseville put forward for the information of the Committee two papers prepared by OECD. These papers were entitled "Resolving issues that prevent a mutual agreement: supplementary mechanisms for dispute resolution" and "A guide to the mutual agreement procedure under the United Nations Model Double Taxation Convention between Developed and Developing Countries".

62. The presenters were thanked for the informative papers. While these were not documents produced or settled by the Committee, it was noted that they formed a useful resource that should appropriately be included in the work of updating the Manual for the Negotiation of Bilateral Tax Treaties.

63. It was noted that, in order for mutual agreement procedures to function effectively, the principles, as laid out in bilateral treaties based on a model, had to be in place, the rules of practical application had to be understood and the competent authorities had to approach their work in the right spirit of cooperation and willingness to compromise.

64. There was discussion about the relationship between mutual agreement procedures, arbitration and court proceedings; Mr. Sasseville noted that in some countries there was a constitutional dimension to the issue and that, as noted in the paper on mutual agreement procedures, how domestic law remedies and those procedures interacted was thus determined in each contracting State by that State's domestic law and administrative procedures. Many States required the taxpayer to suspend any (at least active) challenge on the same issue in court during the proceedings on mutual agreement procedures. To require a taxpayer to permanently disclaim relevant domestic legal rights where no result might ensue from the proceedings on mutual agreement procedures could, in contrast, deny that taxpayer any legal recourse. However, a permanent waiver of domestic law rights might be a condition for implementing a result agreed to on the basis of a mutual agreement procedure.

65. The point was made that many of the most significant issues in the area of mutual agreement procedures and arbitration were the very practical ones. Drawing up a memorandum of understanding about how arbitration would apply before any dispute arose was, for example, an important way of ensuring the success of such arbitration, and would be a very practical way for the United Nations to assist developing countries. The importance of having the right attitude during proceedings on mutual agreement procedures, being focused on achieving the purposes of the treaty, was also noted.

66. There was a further discussion on arbitration, including its place in assuring potential investors of a stable investment climate. There were different views on whether the decisions in such cases could be made public, although most of those addressing the point considered that the decision itself should not be made public.

The issue of the cost to developing countries was also raised and it was suggested by Mr. Waldburger that there might be ways of addressing this, such as cost-sharing based on relative gross domestic product. He noted that the taxpayer could also contribute to the cost. On the other hand, some participants emphasized that it might not be appropriate to require a contribution to costs from taxpayers, noting that some methods of alternative dispute resolution might be more expensive for developing countries than mutual agreement procedures.

67. Some participants expressed the view that there would often need to be a building of confidence in arbitration before it would gain wider acceptance in the area of international taxation. Others noted that many States were still learning the rules in areas such as transfer pricing and it might take some time before they were ready to arbitrate based on those rules; the priority would currently be in gaining expertise in transfer pricing. The possibility of the United Nations maintaining a list of experienced arbitrators was raised, as was the possibility of some form of standing arbitral panel.

68. **Armando Lara Yaffar, the Acting Chairperson, concluded by thanking the presenters and the authors of the two background notes, recognizing that they formed a useful resource that should appropriately be included in the work of updating the Manual for the Negotiation of Bilateral Tax Treaties. He noted that the Subcommittee on Dispute Resolution should, for the rest of the term of the current Committee members, continue to consider the areas of dispute resolution that it would recommend for consideration by the next membership of the Committee. Those participants wishing to make suggestions should send them to the Subcommittee and the Committee secretariat (taxffdoffice@un.org). Finally, it was agreed that a strong recommendation should be made to the next membership of the Committee that improving the mutual agreement procedures and addressing the possibilities for arbitration (either in the United Nations Model Convention or as an alternative provision to it) was important work.**

69. The observer representing Australia (Martin Jacobs) agreed to join the Subcommittee on Dispute Resolution, in place of Paul McBride.

G. Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

70. Frank Brunetti, assisted by Jon Bischel and Stephen Crow, presented a progress report on the current status of the Manual. They indicated that the samples reflected in the three papers presented to the Committee would lead to the next step of the work, where there could be an active dialogue among participants to refine and focus the Manual.

71. The Secretariat indicated that this was a very important project, in which it took great interest, and noted that a Manual with a practical and solutions-oriented focus would be very valuable. It was suggested that Mr. Wijnen of the International Bureau of Fiscal Documentation should perhaps be approached with a view to updating the study in the 2003 version of the Manual as to the actual usage in bilateral treaties of particular United Nations Model Convention provisions. That could form a useful insight for the future work of the Committee. It was agreed that

this approach could be made by the Secretariat in consultation with the Working Group on General Issues in the Review of Commentaries.

72. Similarly, it was agreed that the Secretariat and OECD could usefully discuss the possibility of sharing some of the OECD web-based resources of equal relevance to the United Nations Model Convention, to the extent possible. In this and other areas, it was important that those contributing resources and skills to the project be appropriately attributed.

73. **The general view was that, in order to provide its full impact, the Manual needed to be an interactive web-based product. The Secretariat agreed, but noted that achieving that might require resources not currently available to it, in particular if a website in all six official languages of the United Nations was sought. For that reason, it considered that a parallel printed product would be required and noted that this might even have to represent a first stage. This would allow the Manual to find its role in assisting those working in other languages. Some called for a loose-leaf publication, although the Secretariat noted that loose-leaf products tended not to be updated over time and a web-based approach might achieve the updating process more easily, including by releasing new, downloadable versions on the Internet.**

74. **The point was made that valuable work could be undertaken in the area of examining whether and how a tax treaty should be negotiated with another State, especially in view of the always limited negotiating resources available to developing and developed countries alike. This could include political analysis of the relationship, economic analysis (including of investment flows) and legal analysis (including of domestic law, comparable treaties and the general legal and administrative infrastructure of the prospective treaty partner). This would be followed by consideration of who would be tasked with the negotiations, including composition of the team by area of expertise and ministry or work group, and then some advice on the process of negotiation. The need to reflect the more modern treaty practices when citing treaty provisions was noted, as this would give most guidance to negotiators.**

75. **The proposed format of the Manual was approved and it was agreed that the Working Group would continue its work taking into account the current discussions.**

H. Treatment of Islamic financial instruments

76. Moftah Jassim Al-Moftah and Salah Gueydi presented the conclusions of the Subcommittee on Treatment of Islamic Financial Instruments. They referred to their paper prepared for the third session of the Committee. That paper addressed the issues raised by such instruments, to which the concept of the payment of interest did not relate, in the context of article 11 of the United Nations Model Convention, dealing with interest. They noted that the paper for the current session contained proposed wording for the commentary on article 11, including the text of a new optional provision in the article that would assimilate the treatment of such instruments, where appropriate, to the treatment of similar interest-bearing instruments. It was noted that this was an approach already taken under domestic law in Malaysia, Singapore and the United Kingdom.

77. **The Working Group had proposed wording for new paragraphs 20.1 to 20.4 of the commentary of the United Nations Model Convention, which would be inserted between quoted paragraphs 21.1 and 22 of the commentary of the OECD Model Convention (at page 175 of the United Nations Model Convention). A new paragraph 20.5 would then follow, starting with the words "The OECD commentary then continues:" followed by the existing quotations of paragraphs 22 and 23 of the commentary of OECD Model Convention. That wording was agreed for inclusion in the next version of the United Nations Model Convention, except that the words "domestic law" in proposed paragraph 20.1 would be changed to "domestic tax law". It was noted that other articles, such as article 12 dealing with royalties and article 13 dealing with capital gains, might need to be amended in future to deal with specific Islamic financial instruments, but that it was better to wait until the part of the Manual dealing with such financing had been released and there had been an opportunity to comment thereon.**

78. **The Acting Chairperson noted that the Working Group had completed its work and thanked the members for their work.**

Chapter IV
Dates and agenda for the fifth session of the Committee

79. The Committee discussed its future agenda. There was general agreement that the agenda needed to be driven by the needs of developing countries. The Committee noted the unfinished agenda from its current work, which should be carried over to the agenda of the next membership of the Committee subject, of course, to the views of that membership as constituted in 2009. This would include the updating of the United Nations Model Convention and the United Nations draft Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance.

80. There was also a suggestion that issues beyond updating the United Nations Model Convention needed to be considered, although the resource constraints were noted. Many participants noted the importance of tax administration, as long as it was approached with a focus on particular areas of greatest need so that the work was targeted, relevant and achievable; this should include in particular expanding the work on transfer pricing, including developing a practically oriented manual on transfer pricing issues for developing countries, with a checklist or checklists of issues. With regard to transfer pricing, it was noted that a subcommittee might need to be established with a view to taking responsibility for that work, in conjunction with the work being done as part of the project on South-South sharing of successful tax practices. In the meantime, the Secretariat would perform a liaison role to involve interested members of the Committee in the work on that project.

81. There was also support for further work on the issue of royalties and technical fees, even though the focus of the Subcommittee on the Definition of Permanent Establishment would, for the present, not be on that issue.

82. Other key topics that were suggested were (a) work on the broader strategic issues in treaty negotiation, in particular on how treaties were developed and negotiated, with Mr. Thuronyi offering to prepare a background paper on the topic; (b) how the United Nations Model Convention was actually applied in existing bilateral treaties; and (c) understanding better why some developing country treaties deviated from the United Nations Model Convention, and whether such deviations should be better reflected in the United Nations Model Convention and its commentaries.

83. There was a suggestion that all future Committee members should participate in at least one of the subcommittees or working groups, which could be structured to better reflect broad categories of subjects, such as tax treaties, transfer pricing and administration. Given the participation in the Committee's work by observers with extensive experience, each subcommittee should invite those observers to participate in its deliberations.

84. There was extensive discussion on the need to expand the Committee's work in giving guidance for capacity-building with a view to enhancing developing countries' capabilities in treaty negotiations and international tax law. It was noted that there were other efforts by other institutions with which the United Nations had been collaborating, but that effort should be enhanced further and be focused on issues (or aspects of issues) such as in the areas of transfer pricing, incentives for foreign direct investment, tax competition and risk management, which were inadequately served elsewhere. It was also noted that should the Doha Conference

call for greater efforts in combating tax avoidance, future training workshops might also focus on this matter with a view, in particular, to expanding South-South cooperation.

85. The issue of tax competition and the so-called "race to the bottom" on tax incentives was discussed. While the importance of the issue was recognized, the risks of a general discussion that lacked sufficient focus and did not practically assist developing countries was acknowledged also. The Secretariat's offer to prepare or commission a focused paper addressing some of the issues in a particular regional context but seeking to draw conclusions of wider relevance, was accepted. The possibility of future work in the area of value added taxes was also recognized.

86. The importance of capacity-building to the work of the United Nations related to tax matters was also noted. In that respect, the Government of Viet Nam reiterated its offer, made at previous sessions, to host a regional capacity-building training workshop in 2009, subject to addressing funding issues. The Secretariat noted an offer from Pakistan as well, which had been raised at some of the previous sessions. Malaysia indicated that it had programmes that could assist participation by representatives from other countries in training held in Malaysia.

87. There was considerable discussion about whether the issues surrounding attribution of profits under article 7 of the United Nations Model Convention should be considered. It was noted that current developments internationally could have a serious impact on developing countries and source country taxation generally, and the Committee should have a role in shaping those developments. Others expressed the view, however, that in such a difficult area it was better to wait for the conclusion of the work at OECD, despite the differences between the United Nations and OECD model conventions. Mr. Oliver offered to prepare for circulation among Committee members a short paper on some of the issues that might be involved, to allow for further consideration, including by the new membership of the Committee in 2009.

88. After extensive discussions, the Committee decided that its proposed draft agenda for the fifth session would be as set out below, recognizing that some discussions would be very short, that a longer rather than a shorter agenda at this stage might assist the new membership of the Committee in 2009, and that the next iteration of the Committee might well revisit the agenda before the next annual session.

Draft agenda for the fifth session of the Committee

1. Definition of permanent establishment.
2. Royalties and technical fees: policy and technical issues.
3. Issues related to attribution of profits under article 7 of the United Nations Model Double Taxation Convention between Developed and Developing Countries.
4. Taxation of development projects.
5. The proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance.

6. Revision of the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

7. How treaties are developed: practical issues.

8. Dispute resolution.

9. General issues in the review of the commentaries of the United Nations Model Convention.

10. Transfer pricing, including a manual and checklist for developing countries.

11. Tax competition in corporate tax: tax incentives that have worked and not worked in attracting foreign direct investment.

12. Dates and agenda for the sixth session of the Committee.

13. Adoption of the report of the Committee on its fifth session.

89. **The Committee decided to hold its fifth session from 19 to 23 October 2009.**

Chapter V

Adoption of the report of the Committee on its fourth session

90. The Committee approved and adopted the present report for submission to the Economic and Social Council.

91. In the course of its current session, the Committee reiterated its request, contained in the reports on its previous sessions, for additional resources that were needed for face-to-face subcommittee and working group meetings, with special reference to ensuring full and effective participation of members of those subcommittees and working groups from developing countries. The Committee also reiterated the importance of additional resources for organizing capacity-building workshops in developing countries and countries with economies in transition. In that connection, it was noted that both Viet Nam and Pakistan had restated their willingness to host training workshops.

Chapter VI
Conclusions and policy recommendations

92. The following paragraphs set out the conclusions reached under each agenda item, as reflected in the body of the present report.

General issues in the revision of the commentaries

93. **The Working Group was tasked to continue its work in considering general issues in the review of the commentaries, with a view to a further paper being available to the new membership of the Committee in 2009.**

Taxation of development projects

94. **Mr. Thuronyi urged participants to discuss the issue with their relevant ministries or agencies in their capitals, and it was agreed that wording would be provided to the Chairperson so that he could consider whether it could be included in his proposed letter on the Doha Conference referred to in paragraph 20 above. The matter was subsequently addressed in the Chairperson's letter.**

Definition of permanent establishment

95. **Mr. Sollund indicated that, in view of the positions expressed, in many cases supporting the proposals for replacing article 14 and in many other cases supporting the retention of article 14, there might be a way forward that met broad acceptance. That approach could be to:**

(a) **Reconfigure the way the issue was addressed, so that article 14 was retained in the United Nations Model Convention;**

(b) **Provide an alternative for those preferring to remove article 14 and apply articles 5 and 7 to situations previously dealt with under article 14, without reducing the source country rights under the current article 14;**

(c) **Ensure that the Subcommittee liaised with some of the Committee members and observers who had raised specific issues that should be addressed in the further work of the Subcommittee. In that respect, comments could also be sent to Mr. Sollund, as coordinator of the Subcommittee, on the issues raised in the discussion concerning what would now be an alternative article 5 and its commentary for countries wishing to delete article 14;**

(d) **Focus at present on that part of the Subcommittee mandate relating to the possibility of an alternative to article 14, with a view, as far as possible, to completing its consideration by the end of June 2009 when the terms of the current members of the Committee expired, leaving further work on fees for technical services and a possible revision of article 14 and its commentary as matters for consideration by a future membership of the Committee.**

96. **The Subcommittee was mandated to so proceed. However, the Committee considered that the issue of updating and improving article 14 was an important one that should be dealt with by a new Subcommittee on article 14 and the Tax Treatment of Services. Ms. Kana agreed to coordinate the Subcommittee and Habiba Louati and Anita Kapur also agreed to participate.**

Observers with expertise in the area would also be asked to participate in the work of the Subcommittee. The Subcommittee was asked to commence its work as soon as possible with a view to achieving as much as possible before July 2009, when the new membership of the Committee would commence their terms of office.

Improper use of treaties

97. It was concluded that there was a need to refine (fine-tune) the concept of beneficial ownership, including by examining developments in the OECD Model Convention, and it was agreed that Mr. Baker's paper could contribute to the process of improved understanding by its appropriate inclusion in the Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries.

98. It was also agreed that practical application of the concept of beneficial ownership, including how to certify beneficial ownership, should be recommended to the next membership of the Committee as a subject worthy of its consideration, one which could be elaborated on in the Manual. In that respect, any cases and materials on the application of the concept of beneficial ownership in developing countries would be particularly useful for such consideration. Taking into consideration the work being done at OECD, it was also agreed to have feedback from OECD as to its work on beneficial ownership.

99. Having decided that there was no need for the Subcommittee on Improper Use of Treaties to further examine the issue of beneficial ownership, attention turned to the Subcommittee's paper on proposed additions to the United Nations Model Convention and commentary addressing approaches to dealing with improper use of treaties. The paper was a revised version of the paper presented at the third session. It was agreed that the paper was finalized, subject to a small number of minor changes. This included examining whether the proposed paragraph 5 of article 13 should be expressed, as in the current Model Convention, as not affecting paragraph 4 and, if necessary, making that change. The changes also included ensuring that in the same paragraph 5 the reference to "that State" was changed to "that other State", to ensure that it referred to the State of residence of the company.

100. After the Committee had finished its discussion of dispute resolution, and in the light of that discussion, it decided to remove the square brackets surrounding text in the last sentence of paragraph 103 of the report contained in conference room paper E/C.18/2008/CRP.2, but to also delete the phrase ", combined with arbitration to deal with cases that competent authorities cannot resolve,". The last sentence of paragraph 103 would then read:

> "Similarly, an effective application of the mutual agreement procedure will ensure that disputes concerning the application of anti-abuse rules will be resolved according to internationally accepted principles so as to maintain the integrity of tax treaties."

101. The Chairperson noted that this concluded the work of the Subcommittee on Improper Use of Treaties and he thanked the Subcommittee for its successful work.

Exchange of information, including the proposed United Nations Code of Conduct on Cooperation in Combating International Tax Evasion and Avoidance

102. Based on the discussion, the proposed new article and its commentary was agreed to be finalized, the only change being that in paragraph 2 the words "However, if the information is originally regarded as secret in the transmitting State," should be removed and replaced with the word "and", as it was not considered that this conditionality was necessary to the paragraph.

103. It was agreed that the Subcommittee should continue its work on the Code, drawing on the discussions and the submissions that had been invited, which would include submissions on the title, structure, goals, objectives and commitments outlined in the document.

104. It was also agreed that an updated version of the Code should be made available by the time the Doha Conference took place, with an introductory paragraph and styled as a "technical working draft" or similar.

Dispute resolution

105. Armando Lara Yaffar, the Acting Chairperson, concluded by thanking the presenters and the authors of the two background notes, recognizing that they formed a useful resource that should appropriately be included in the work of updating the Manual for the Negotiation of Bilateral Tax Treaties. He noted that the Subcommittee on Dispute Resolution should, for the rest of the term of the current Committee members, continue to consider the areas of dispute resolution that it would recommend for consideration by the next membership of the Committee. Those participants wishing to make suggestions should send them to the Subcommittee and the Committee secretariat (taxffdoffice@un.org). Finally, it was agreed that a strong recommendation should be made to the next membership of the Committee that improving the mutual agreement procedures and addressing the possibilities for arbitration (either in the United Nations Model Convention or as an alternative provision to it) was important work.

Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries

106. The general view was that, in order to provide it full impact, the Manual needed to be an interactive web-based product. The Secretariat agreed, but noted that achieving that might require resources not currently available to it, in particular if a website in all six official languages of the United Nations was sought. For that reason, it considered that a parallel printed product would be required and noted that this might even have to represent a first stage. This would allow the Manual to find its role in assisting those working in other languages. Some called for a loose-leaf publication, although the Secretariat noted that loose-leaf products tended not to be updated over time and a web-based approach might achieve the updating process more easily, including by releasing new, downloadable versions on the Internet.

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of the relationship, economic analysis (including of investment flows) and legal analysis (including of domestic law, comparable treaties and the general legal and administrative infrastructure of the prospective treaty partner). This would be followed by consideration of who would be tasked with the negotiations, including composition of the team by area of expertise and ministry or work group, and then some advice on the process of negotiation. The need to reflect the more modern treaty practices when citing treaty provisions was noted, as this would give most guidance to negotiators.

108. The proposed format of the Manual was approved and it was agreed that the Working Group would continue its work taking into account the current discussions.

Treatment of Islamic financial instruments

109. The Working Group had proposed wording for new paragraphs 20.1 to 20.4 of the commentary of the United Nations Model Convention, which would be inserted between quoted paragraphs 21.1 and 22 of the commentary of the OECD Model Convention (at page 175 of the United Nations Model). A new paragraph 20.5 would then follow, starting with the words "The OECD commentary then continues:" followed by the existing quotations of paragraphs 22 and 23 of the commentary of the OECD Model Convention. That wording was agreed for inclusion in the next version of the United Nations Model Convention, except that the words "domestic law" in proposed paragraph 20.1 would be changed to "domestic tax law". It was noted that other articles, such as article 12 dealing with royalties and article 13 dealing with capital gains, might need to be amended in future to deal with specific Islamic financial instruments, but that it was better to wait until the part of the Manual dealing with such financing had been released and there had been an opportunity to comment thereon.

110. The Acting Chairperson noted that the Working Group had completed its work and thanked the members for their work.

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